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In the Supreme Court of the United States

OCTOBER TERM, 1957

No. 624

ALBERT TOWERS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ALBERT AVERBACH, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The prevailing and dissenting opinions in the Tax Court (R. 4a–64a)[1] are reported at 24 T. C. 199.[2] The

[1] Record references are to the Appendix to the taxpayers' brief in the Court of Appeals.

[2] These cases were consolidated with several other cases in the Tax Court, and the Tax Court's opinion is reported *sum nom. Samuel Towers, et al.* v. *Commissioner.* All of the cases were appealed to the Court of Appeals for the Second Circuit, and all of them (except one where the appeal was dismissed on stipulation (Pet. 23, 29)) were affirmed by that court. A sep-

opinion of the Court of Appeals (Pet. 23–29) is reported at 247 F. 2d 233.

JURISDICTION

The judgments of the Court of Appeals were entered on August 2, 1957. On October 31, 1957, by order of Mr. Justice Harlan, the time for filing a petition for a writ of certiorari was extended to and including November 29, 1957. The petition for a writ of certiorari was filed on November 25, 1957. The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTIONS PRESENTED

1. Whether the petitioners were deprived of constitutional rights under the Fifth Amendment to the Constitution because the findings and majority opinion of the Tax Court were prepared by a judge other than the one before whom the cases were tried.

2. Whether the courts below correctly held that certain advances made by petitioners to a corporation in which they were interested were nonbusiness bad debts and could not be deducted as business bad debts under Section 23 (k) of the Internal Revenue Code of 1939.

3. Whether the courts below correctly held that advances made by the petitioners to a "motor pool" were in reality loans which could be deducted only as nonbusiness bad debts and not as business bad debts or losses under Section 23 of the Code.

4. Whether in the circumstances the courts below were justified in holding that the proceeds of certain

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arate petition for certiorari filed by Theodore C. Bonney (No. 585, this term), relating to a question not involved in the instant proceedings, was denied on December 16, 1957.

claims that had been assigned to petitioners were taxable to them as ordinary income in the year when such proceeds were distributed to and received by them.

5. Whether the courts below correctly held that petitioner Towers failed to prove himself entitled to deductions for business bad debts with respect to losses resulting from endorsements of certain notes.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *
>
> (26 U. S. C. 1952 ed., Sec. 22.)
>
> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (e) Losses by Individuals.—In the case of an individual, losses sustained during the taxable

year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *

* * * * *

(k) [as amended by Sec. 124 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 113 of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Bad Debts.*—

(1) *General Rule.*—Debts which become worthless within the taxable year; or (in the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. * * * This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection.

* * * * * *

(4) *Non-Business Debts.*—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3), and other than a debt the loss from the

worthlessness of which is incurred in the taxpayer's trade or business.

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

STATEMENT

The petitioners, Albert Towers and Albert Averbach, seek review of a decision of the Court of Appeals for the Second Circuit unanimously affirming a decision of the Tax Court in a consolidated proceeding involving the income taxes of five taxpayers (including the two petitioners) for the years 1944 to 1947.

The Tax Court made detailed findings of fact (R. 12a), all of which were accepted by the Court of Appeals (Pet. 24–29). Since the five issues tendered by the petition for certiorari are essentially separate in nature, it seems desirable to summarize the findings relating to each issue separately, and this will be done below in connection with the argument on that issue.

ARGUMENT

1. Petitioners principally contend (Pet. 7, 22) that they were deprived of rights under the Fifth Amendment because the findings and the majority opinion in the Tax Court were prepared by a judge other than the one before whom the cases were tried.

The trial was conducted by Judge Black but, due to Judge Black's subsequent resignation from the Tax Court, Judge Fisher prepared the findings and the majority opinion. The case was reviewed by the full Tax Court, which ordinarily consists of sixteen judges, and there were dissents on certain issues. After pro-

mulgation of the Tax Court's opinion, petitioners made motions for rehearing, further hearing, and reconsideration. These motions were argued before Judge Fisher and denied by him after careful consideration. (Pet. 24–25; R. 4a–64a.)

In the circumstances, there is no foundation for petitioners' contention that they were not accorded due process, and the Court of Appeals rightly characterized that contention as being "utterly without merit." (Pet. 25.) It has consistently been recognized that the findings and opinion of the Tax Court do not have to be written by the judge who conducted the trial, and this Court has denied review in several cases of this nature. *Seaside Improvement Co.* v. *Commissioner*, 105 F. 2d 990, 992 (C. A. 2d), certiorari denied, 308 U. S. 618; *Halle* v. *Commissioner*, 175 F. 2d 500, 504 (C. A. 2d), certiorari denied, 338 U. S. 949; *Hamlin's Trust* v. *Commissioner*, 209 F. 2d 761, 763–764 (C. A. 10th); *Amoroso* v. *Commissioner*, 193 F. 2d 583, 586 (C. A. 1st), certiorari denied, 343 U. S. 926; *Powell* v. *Commissioner*, 94 F. 2d 483, 485–486 (C. A. 1st). No greater warrant for review exists here.

2. Petitioners further contend (Pet. 8, 20) that certain advances which were made in 1947 to Rumsey Products, Inc., and which became worthless in the same year, are deductible as business bad debts under Section 23 (k) of the 1939 Code (*supra*, p. 4).

Sometime in 1939, with war impending, petitioners together with three others became interested in a promotional service whereby idle machine facilities might be utilized in the production of war materials. (R. 14a). They organized a corporation (Rumsey Manu-

facturing Corp.) to do prime contract work, and it operated a plant in Seneca Falls, New York, very successfully during World War II. Petitioners and their associates were variously connected with the corporation as stockholders, employees, officers, and directors. (R. 17a–18a.)

After the close of the war, it became desirable to shift activities and to undertake peace-time production, and a new corporation (Rumsey Products) was organized in November 1946 to manufacture electric lawn-mowers and automotive jacks. Each of the five, including the petitioners, contributed cash and received stock of the new corporation in return. (R. 19a–20a.) The new corporation failed and petitioners realized the losses referred to above when it went bankrupt in 1947. (R. 20a, 23a.)

Petitioner Towers' main activity from 1942 to 1947 was directed to the operation of these corporations (Rumsey Manufacturing and Rumsey Products). Petitioner Averbach's main activity was the practice of law. (R. 19a.)

The Tax Court held that their loans to Rumsey Products, which became worthless in 1947, are deductible only as nonbusiness bad debts (R. 28a), and the Court of Appeals affirmed. (Pet. 26.)

We submit that the decision is correct. Although petitioners were engaged in some promotional activities—and that was stipulated (R. 12a)—still they were not pursuing those activities when they made the loans in question. They made the loans without interest in many instances, and the loans were made to a corporation in which petitioners and their as-

sociates were variously interested as stockholders, officers, directors, or employees. These loans appear to have been merely accommodation advances made from necessity, because of petitioners' practical interest in the company. In short, petitioners were not engaged in any business to which the losses were proximately related.

Petitioners cite cases (Pet. 20) such as *Giblin* v. *Commissioner*, 227 F. 2d 692 (C. A. 5th); *Maloney* v. *Spencer*, 172 F. 2d 638 (C. A. 9th) and *Campbell* v. *Commissioner*, 11 T. C. 510 (Acquiescence, 1949-1 Cum. Bull. 1), where the courts held the losses were proximately connected with the business of the taxpayers. In this field, however, each case necessarily turns on its particular facts, and petitioners' suggestion of a conflict is without substance.

Here there is substantial evidence to support the finding that the corporation's business was not an incident to the petitioners' promotional ventures but was instead an independent enterprise. See *Commissioner* v. *Smith*, 203 F. 2d 310 (C. A. 2d), certiorari denied, 346 U. S. 816; *Gulledge* v. *Commissioner*, decided November 7, 1957 (C. A. 4th); *Putnam* v. *Commissioner*, 352 U. S. 82; *Burnet* v. *Clark*, 287 U. S. 410.

In any event, the question is not one of general importance which would warrant further review.

3. On February 3, 1947, Rumsey Products entered into an agreement with Rose Towitz, acting for herself and as agent for petitioners (and their associates), to handle sight draft shipments of motors to the company which it was not prepared to meet.

(R. 29a–30a.) Pursuant to this agreement, petitioners made advances to a so-called "Rose Towitz Pool." (R. 30a–32a.)

The significant function of petitioners was to supply the needed funds, for which they were to receive 50 cents per motor from Rumsey Products. All of the motors were in fact turned over directly to Rumsey Products to be used in manufacturing lawn mowers. Likewise, the funds contributed were used by or for Rumsey Products to finance the sight draft shipments. (R. 32a.)

The monies advanced by the contributors to the pool were lost as a result of the Rumsey Products bankruptcy in 1947. (R. 33a.)

Rejecting petitioners' contention that these advances are deductible as business losses or business bad debts under Section 23 (e) and (k) of the Code (*supra*, pp. 3–4), the Tax Court held (R. 33a–36a) that the items in question, having become worthless in 1947, and not having been incurred in a trade or business, must be treated as nonbusiness bad debts. The Court of Appeals affirmed. (Pet. 26–27.)

Both courts rejected the contention of petitioners that they bought the motors and resold them to Rumsey Products and that the losses are accordingly deductible as business losses or losses in transactions entered into for profit. Both courts construed the arrangements in question as amounting to loans to the company to enable it to buy motors and not as purchases of motors by petitioners with resales to the corporation. This was certainly a permissible

evaluation of the evidence, and in any event the question is of no significance beyond the confines of this particular case.

4. Petitioners now contend (Pet. 8, 21) that the Court of Appeals erred in not holding that the proceeds of certain assigned claims are taxable to the assignor (Balch) and not to themselves as assignees. But this question was not raised by petitioners in the Court of Appeals, was not decided by the Court of Appeals, and accordingly is not properly presented here. *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415.[3] Moreover, the facts give no support to the taxpayers' contention.

In 1941, John Balch assigned a four-fifths interest in certain claims for commissions, due him from Morris, which passed equally to petitioners and two of their associates. Balch kept for himself a one-fifth interest. This group subsequently reassigned the claims to John Balch, who assigned them in turn to Rumsey Manufacturing to be used as collateral. They were carried on the books of Rumsey Manufacturing as donated surplus in the amount of $28,381.50. It was understood that the assigned claims, or the proceeds therefrom, would be distributed to the assignors when no longer needed for credit purposes. Meanwhile, the assignors' right to demand repayment was

[3] Taxpayers urged in the Court of Appeals that the Tax Court had erred (1) in going beyond the issue joined (*i. e.*, whether or not the payments amounted to a dividend) and (2) in holding that taxpayers had failed to prove any basis for receivables which could be deducted in computing gain. The Court of Appeals upheld the Tax Court on both those issues. (Pet. 27-28.)

subordinated to creditors and preferred stockholders of the company. (R. 40a–41a.)

In 1943, Rumsey Manufacturing received $28,381.50 on these claims by way of set-off of a claim of Morris against Rumsey Manufacturing. On October 1, 1945, Rumsey Manufacturing repaid this amount to the five common stockholders. In this connection, the directors passed a resolution reciting that the debts were paid or provided for, that the preferred stock had been called for redemption, and that distribution of the $28,381.50 to the five common stockholders was in order. (R. 41a–42a.)

The petitioners considered the original assignment from Balch as a gift to them. They treated the amounts received in 1945 as repayment of a loan and did not report such amounts as income. The Commissioner treated these payments as dividends, but the Tax Court held they were repayments of loans. However, it also held that the repayment of the loans accomplished simultaneously the collection for petitioners of the receivables which had been the subject of the loans and that the full amount paid to petitioners was income to them since there was no proof as to basis. (R. 44a–45a.) The Court of Appeals affirmed. (Pet. 27–28.) See *Oseubach* v. *Commissioner*, 198 F. 2d 235, 236–257 (C. A. 4th).

It is apparent from the foregoing that this is an entirely different situation from cases such as *Lucas* v. *Earl*, 281 U. S. 111, and kindred cases where the assignor of income who controlled the source was not permitted to deflect the income to a member of his family and thus reduce his taxes. Here there was a

business and not a family relationship between assignor and assignee and, moreover, the Commissioner is asserting the tax against the assignees who received the money. In the circumstances, he is clearly justified in holding them to the arrangements that they made with the assignor. The Commissioner, and not the taxpayer, has the choice in a case of this character. *Gray* v. *Powell,* 314 U. S. 402, 414; *Higgins* v. *Smith,* 308 U. S. 473, 477.

5. With respect to petitioner Towers' claim of a business bad debt deduction for losses from endorsing certain notes, the Tax Court held (R. 59a–60a) that the taxpayer failed to prove that he was in a trade or business which included as a part of its activities the incurring of these particular obligations or the subsequent payment thereof. The Court of Appeals, in affirming, said (Pet. 28) that proof was lacking that these particular losses were proximately related to the promotional activities of the taxpayer. In renewing his contention here, taxpayer Towers is merely requesting this Court to pass upon a question of fact that has been resolved against him by both courts below. *Comstock* v. *Group of Investors,* 335 U. S. 211, 214.

CONCLUSION

The decision below is correct, there is no conflict, and no question of general importance is presented. Accordingly it is respectfully submitted that the petition for a writ of certiorari should be denied.

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DECEMBER 1957.